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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Minnesota Tea Company, petitioner above named, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit, entered in the above entitled cause on April 7, 1937.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 13 ff.) is reported in 34 B. T. A. 145.

The opinion of the Circuit Court of Appeals is not yet officially published, but may be found in 374 C. C. H., page 9780 ¶9228, (R. 36 ff.).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 7, 1937. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Whether the fact that stockholders assume and pay certain indebtedness of a corporation pursuant to a statutory reorganization, renders the corporation subject to tax on a gain which otherwise would not be recognizable to it under the provisions of Sec. 112(d) of the Revenue Act of 1928.

Statutes and Regulations Involved.

The pertinent statutes and regulations involved will be found in the Appendix.

Statement.

On August 23, 1928, pursuant to a plan of statutory reorganization (see *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Minnesota Tea Co.* v. *Commissioner*, 76 F. (2d) 797), Minnesota Tea Company transferred all its property to the Grand Union Company, in exchange for 18,000 shares of the common stock (voting trust certificates) of the latter company, plus $426,842.52 in cash. Pursuant to the plan of reorganization, Minnesota Tea Company thereupon distributed all the cash to its stockholders, who assumed and agreed to pay, and later actually paid, liabilities of the petitioner to the extent of $106,471.73.

The resolution of the stockholders of the petitioner under which the cash was distributed is as follows:

> "Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be im-

mediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholders in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent'' (R. 28).

In his notice of deficiency (R. 7-12) the Commissioner of Internal Revenue proposed a deficiency of $11,587.64, on the theory that to the extent that liabilities of the petitioner had been assumed by the stockholders, the petitioner had not made distribution of the cash within the meaning of Section 112(d) of the Revenue Act of 1928, and that taxable gain of $106,471.73, the amount of said liabilities, was therefore recognizable and taxable to the petitioner.

The matter was thereupon brought before the Board of Tax Appeals for Review, upon the sole issue of whether or not the petitioner realized a taxable gain of $106,471.73 as a result of the transactions above set forth. No contention was made by the Government that the petitioner was taxable upon any greater sum than that amount. The Board of Tax Appeals, however, of its own motion, raised the question as to whether such statutory reorganization

had been effected; and, in its decision, held that there was no reorganization, but a sale of assets, and that petitioner was taxable on the gain thereof. The case was then reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, which (76 F. (2d) 797) reversed the Board of Tax Appeals in its conclusion on the reorganization question, and remanded the case to the Board of Tax Appeals for determination of the original issue. This Court granted certiorari (296 U. S. 562) on application of the Commissioner of Internal Revenue, and later affirmed the Circuit Court (296 U. S. 378). Upon affirmance by this Court, the Board of Tax Appeals, after a hearing pursuant to the mandate, in an opinion promulgated March 18, 1936, reported in 34 B. T. A. 145, held that the sum of $426,842.52 having been entirely distributed to the shareholders pursuant to the plan of reorganization, and in conformity to the reorganization provisions of the Revenue Act of 1928, no part thereof may be regarded as recognizable gain to the corporation, notwithstanding the assumption by the shareholders of the corporate debts.

Upon petition of the Commissioner of Internal Revenue, the Circuit Court of Appeals reviewed this second decision of the Board of Tax Appeals and, reversing the Board, held (R. 36 ff.) that notwithstanding literal compliance with the statute, the payment of the corporate debts by the stockholders under the circumstances here presented resulted in taxable gain to the corporation, up to $106,471.73, the amount of said debts.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1) In holding that it is an exemption from taxation which is claimed by petitioner, and that upon it lies the burden of establishing the right thereto.

2) In failing to hold that it is the Government which claims an exemption from the operation of the statute, and upon it lies the burden of establishing such claim.

3) In holding that payment of the entire amount of cash received by Minnesota Tea Company from Grand Union Company to its stockholders in proportion to their stockholdings was not a distribution within Sec. 112(d)(1) of the Revenue Act of 1928.

4) In failing to hold that the transaction here involved constituted a compliance with Sec. 112(d) and hence that no gain should be recognized to the corporation.

5) In holding that the petitioner did not comply with Sec. 112(d) of the Revenue Act of 1928.

6) In holding that there was taxable gain to the petitioner by reason of the fact that its stockholders assumed and paid its liabilities.

7) In reversing the decision of the Board of Tax Appeals.

Reasons for Granting the Writ.

1) That the Circuit Court of Appeals for the Eighth Circuit has decided an important question of Federal law which has not been, but should be, settled by this Court.

2) That the Circuit Court of Appeals for the Eighth Circuit has decided a Federal question in a way probably in conflict with the applicable decisions of this Court.

The decision of the Circuit Court of Appeals for the Eighth Circuit in this case, if not reversed, will create confusion and uncertainty in the application of the reorganization provisions of the Federal income tax laws, in that the taxpayer can never be certain whether, notwithstanding compliance with the statute, he may be held to have ren-

dered himself liable to tax by selecting the wrong method of compliance.

In corporate mergers and reorganizations, the assumption of liabilities and the payment of debts is a very usual feature. The principal purpose and object of the negotiations leading up to a plan of reorganization is to reach an agreement or establish a basis as to the price to be paid for the *net* value of the stock or property to be transferred. When this has been done, it is largely a matter of legal detail and selection of mechanics as to the method by which the debts are paid. The more frequent ways in which this is done are:

1) The transferee may pay the transferor only the net worth of the assets and assume the liabilities (as was done in some of the cases hereinafter cited);

2) The transferor, before the actual transfer, may pay its own debts;

3) The transferee may pay the transferor the gross value of its assets but require the liabilities to be paid by it later from the cash received from the transferee; or,

4) The transferor may require its stockholders to pay the corporate debts (as in this case).

The financial result to the transferor is exactly the same in all four cases. It should, therefore, be made clear by this Court which, if any, of these methods of paying the transferor's debts would defeat compliance with Sec. 112 (d)(1) and render the corporation liable to tax upon the amount of said debts, notwithstanding there may have been a statutory reorganization.

It is believed by the petitioner that the question here involved is of such general importance in the application of the reorganization provisions of the Federal income tax

laws as to bring it clearly within the purview of Rule 38 (5)(b) of the Rules of this Court.

Moreover, there is considerable confusion in the decisions of the lower courts concerning the point here involved and points akin thereto. For example: The Board of Tax Appeals, in *Fashion Center Bldg. Co.*, 31 B. T. A. 167, held that the assumption of indebtedness is not "other property" within the meaning of Sec. 203(d)(1), 1926 Act, corresponding to Sec. 112(d)(1) of the 1920 Act. (See discussion, *infra.*)

The District Court of the United States for the District of Maryland, in *Hendler* v. *United States*, 17 Fed. Supp. 558 (decided December 30, 1936), held that money received by the transferor corporation and applied in pursuance of a plan of reorganization to the payment of debts is not to be treated as a taxable gain to the corporation.

There are numerous decisions where the transferee corporation has assumed liabilities of the transferor and where reorganizations involving this feature were held to be nontaxable without discussion of the point:

See *Coleman* v. *Commissioner*, 81 F. (2d) 455, 46; *G. & K. Mfg. Co.* v. *Commissioner*, 76 F. (2d) 454 (C. C. A. 4); reversed 296 U. S. 389, and remanded to the Board of Tax Appeals; *Starr* v. *Commissioner*, 82 F. (2d) 964 (C. C. A. 4); certiorari denied, 298 U. S. 680; *Watts* v. *Commissioner*, 76 F. (2d) 981 (C. C. A. 2), affirmed 296 U. S. 387; *Tulsa Oxygen Co.* v. *Commissioner*, 18 B. T. A. 1283; *Frank Keel*, 31 B. T. A. 212; *National Pipe & Foundry Co.* v. *Commissioner*, 19 B. T. A. 242; also see Barr & Morris, "Hidden Taxes in Corporate Reorganizations," p. 261, for a discussion of the point here involved.

The ultimate financial effect upon the corporation in the cases last cited (where the transferee corporation assumed the indebtedness) is precisely the same as in the present

case (where the stockholders assumed it). Yet, if the decision of the court below is not reversed, the tax result will be entirely different. Thus taxability is made to depend entirely on the machinery selected, rather than upon what was actually done—a result which is not only not in harmony with the avowed purpose of the Act, but which wholly disregards the plain wording of the statute.

As appears in "Statement of Changes in the Revenue Act of 1921 by the Treasury Department and the Reasons Therefor" prepared for the use of the Ways and Means Committee by A. W. Gregg, Special Assistant to the Secretary of the Treasury (see Appendix), Sec. 112(d) was included in the law in order that the tax results in the case of acquisition of *stock* of a transferor corporation and in the case of acquisition of *properties* of the transferor corporation should be the same, where there is a statutory reorganization.

To reach this sensible result, it was provided that where the corporation was a mere conduit, as here, for passing the proceeds of the sale to the ultimate owner, no recognizable gain should be deemed to accrue to the corporation. Nothing is said or implied in the statute, to the effect that an assumption of corporate debts by stockholders would nullify such procedure.

If the decision of the Circuit Court of Appeals is correct, the tax result can not be the same in cases of stock acquisition as in cases of property acquisition. If the results are not the same in the two types of reorganization, the intention of Congress is not given effect.

If the Grand Union Company had assumed and paid the liabilities of the petitioner and had given the latter only $320,370.79 instead of $426,842.52, the result to the petitioner would be exactly the same as it finally was. But, as above stated, the Board of Tax Appeals, in *Fashion Center*

Bldg. Co., 31 B. T. A. 167, has held that the assumption or payment of liabilities by the transferee corporation is not "other property or money" within the meaning of Sec. 112(d), and accordingly the petitioner would not, in such case, be liable for a tax on the amount of the indebtedness assumed. In other words, the Board of Tax Appeals, in that case refused to view the matter as though the transferor had constructively received the amount of the debts which it did not distribute. This appears to be in accord with the holding in *Coleman* v. *Commissioner*, 81 F. (2d) 455, 456, and other cases hereinbefore cited. However, the Board later indicated, in *Brons Hotels, Inc.* v. *Commissioner*, 34 B. T. A. 376, that it would not follow *Fashion Center Bldg. Co.*, (*supra*) at least in case of exchanges of real estate where mortgage indebtedness is assumed.

Moreover, if the view that assumption of indebtedness is the equivalent of cash, should ever prevail, then the acquisition by one corporation of substantially all the properties of another in return for voting stock plus the assumption of liabilities of the transferring corporation, would not be a reorganization within the statutory definition, as the acquiring corporation would not give "solely" its voting stock in return for the assets. Any such result, we submit, would be unsound and out of harmony with the purpose of the reorganization provisions.

So here, where the result to the transferring corporation was precisely the same as in the example last above cited, consistency demands a similar tax result.

It was natural and proper for the parties to handle the transaction here involved in a manner that would reduce taxes. The statute clearly provided a way to do this. The effect of the decision of the Circuit Court is to disregard what was actually done; to disregard compliance with the

statute and (to use the language of the Board of Tax Appeals in its opinion herein) to convert an "actual distribution *pro tanto* into a constructive nondistribution."

As appears from the legislative history and from the decisions of this Court, the central thought of the reorganization provisions was to remove from ordinary business transactions the deterrent influence of immediate and possibly onerous taxation on merely paper profits, and to make sure that certain business adjustments involving exchanges in kind should not be hindered by the heavy tax burden. The taxation to a corporation of money received by it and distributed to its stockholders (even though they may agree to pay the corporate debts) pursuant to a plan of reorganization, would tend to nullify this intent of the statute. It is not a sufficient answer to say that in such case the tax must be imposed, otherwise a gain will escape taxation. The net gain to the corporation is not evidenced by money used to pay corporate debts, but by what it *retains* or *fails to distribute* to its stockholders; and when the money is distributed, they become ultimately liable to proper taxation on gain actually realized. The intent of the statute, therefore, was to postpone rather than to exempt from taxation.

It is said in the opinion below (R. 38): "It is an exemption from taxation which is here claimed by respondent (petitioner here) and upon it lies the burden of establishing the right thereto." We submit that this view of the matter is not sound, for the reason that it is admitted by the Government, in effect, that the petitioner here has complied literally with the statute. It is, therefore, not the petitioner who seeks exemption from taxation. It is the Government which seeks to nullify compliance with the statute and to claim exemption from its operation. The burden, therefore, is not upon the taxpayer to establish its right to exemption,

but upon the Government to establish its right to collect a tax upon the item in question.

WHEREFORE it is respectfully submitted that this petition should be granted.

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APPENDIX.

Statutes Involved.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. *Determination of Amount of Gain or Loss.*

* * * * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * * * *

SEC. 112. *Recognition of Gain or Loss.*

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

* * * * * * *

(d) *Same—Gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without

the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but—

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

Article 575 of Reg. 74 (1928 Act) provides in part:

* * * If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to the reorganization, for stock or securities in another corporation, a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation

will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case, no loss from the exchange will be recognized. (See Sec. 112(e).)

The provision in question first appeared ~~in~~ the Revenue Act of 1924, as to which the Ways and Means Committee (Rep. M. 179, 68 Cong. 1st Sess., p. 15) reported as follows:

> "There is no provision of the existing law which corresponds to subdivision (d) of the Bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss (sic) to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders, then the gain or loss (sic) is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized, but if it retains all or any part of the proceeds with the result that the transaction is in substance a real sale, then all or part of the gain shall be recognized."

The provision was further explained in "Statement of the Changes in the Revenue Act of 1921 by the Treasury Department, and the Reasons Therefor," prepared for the use of the Ways and Means Committee, by A. W. Gregg, Special Assistant to the Secretary of the Treasury, printed in full in the New York Times for January 5, 1924:

> "A corporation in connection with a reorganization may make distribution of its assets in one of three ways:

"It may transfer them to a new corporation in exchange for stock or cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock or cash to the stockholders of the old corporation; or the new corporation may buy with its stock and cash, from the stockholders of the old corporation, their stock, and then liquidate* the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of constructive receipt by the selling corporation. *If it adopts the third method there is no theory on which any gain to the old corporation could be taxed.*

"As a result of these considerations, subdivision (e) has been so drafted that *the tax liability on the selling corporation is the same, no matter which of the three methods set out above is adopted.* In other words, if the selling corporation is a mere conduit through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, and the same result is reached necessarily, as if the transaction were accomplished through the medium of a purchase by a new corporation of stock of the old corporation, followed by liquidation* of the old." (Italics ours.)

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* See the last paragraph in the opinion in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, where it is held that dissolution is not necessary.